FINAL TRANSCRIPT

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FSP - Q3 2011 Franklin Street Properties Corp Earnings Conference Call

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PRESENTATION

Operator

Good day ladies and gentlemen and welcome to the Q3 2011 Franklin Street Properties Corp Earnings Conference Call. My name is Flithia and I will be your coordinator for today. At this time all participants are in a listen-only mode. We will be facilitating a question and answer session towards the end of today's conference.

(Operator Instructions)

I will now like to turn the presentation over to your host for today's conference, Mr. Scott Carter, General Counsel of Franklin Street Properties Corp. Please proceed sir.

Scott Carter - *Franklin Street Properties Corp - EVP, General Counsel*

Good morning everyone and thanks for joining us on this call. With me this morning are George Carter our Chief Executive Officer and John Demeritt our Chief Financial Officer. Before I turn the call over to John I must read the following statement.

Please note that the various remarks we may make about future expectations, plans and prospects for the company may constitute forward looking statements for purposes of the Safe Harbor provision under the Private Security Litigation Reform Act of 1995. Actual results may differ materially from those indicated by these forward looking statements as a result of various important factors, including those discussed in the risk factors section of our annual report on Form 10K for the year ended December 31, 2010 which is on file with the SEC. In addition, these forward looking statements represent the company's expectations only as of today, November 2, 2011. While the Company may elect to update these forward looking statements, it specifically disclaims any obligation to do so. Any forward looking statement should not be relied upon as representing the company's estimates or views as of any date subsequent to today. At times during this call, we may refer to funds from operations or FFO; a reconciliation of FFO and a GAAP net income is contained in yesterday's press release, which is available on the investor relations section of our website at www.franklinstreetproperties.com. Now I will turn the call over to John Demeritt. John?

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John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

Thank you Scott. Welcome to our earnings call. We are going to be talking with you about third quarter results and I will start with a short overview. Afterwards, George Carter our CEO will further discuss the quarter and FSP. I am going to be brief and I will be referring to our earnings release, the supplemental package and 10-Q that were filed last night.

As of September 30th, we had cash of $44 million and $225 million in availability on our line of credit, giving us about $269 million of liquidity. We also had an asset held for syndication at quarter's end with a carrying value of $4.7 million. As we sell the remaining shares in that deal, it will be converted into cash.

At quarter end we had $375 million in unsecured debt and our total market capitalization was about $1.3 billion. We only have unsecured debt on our balance sheet and our debt to total market cap ratio was 28.6 as of September 30. This leverage ratio continues to provide an attractive loan to values for our lenders and affords our shareholders a significant and more conservative equity investment in our real estate.

On the income statement, we measure our performance with some key drivers which we've talked about before and includes FFO and gain sale of assets or GOS. For the third quarter of 2011, FFO was up about $300,000 compared to our third quarter last year. We did acquire a property on September 30th, but there wasn't a meaningful contribution from that this quarter so we will report on that in the 4th quarter.

We had the benefit of some new leases signed in the third quarter or the last few months over leases that expired, though included in our lease space at quarter end, we reported 88.1% as leased, included in that were about 2.3% that were not FFO producing as September 30th. We expect that 1.7 %of that 2.3% will commence during the fourth quarter and be FFO producing.

Our investment bank contribution was greater in the third quarter 2011, compared to third quarter 2010, though less significant than the last quarter to be sure. We had $7.5 million in gross syndication proceeds during the third quarter of this year compared to only $300,000 in the third quarter of last year. George will be talking a lit bit more about that.

As far as GOS is concerned we didn't sell any properties in either Q3 2011 or Q3 2010. So that is a brief overview of the financial performance. The earnings release, supplemental and 10-Q filing will go into further detail about the results and we can take more questions the end if you want to discuss anything further. So this concludes the financial highlights and at this point our CEO George Carter will tell you more about FSP, the results and were we are. Thanks for listening. George?

George Carter - *Franklin Street Properties Corp - President, CEO*

Thanks John and thank you everyone for tuning in to Franklin Street Properties fourth quarter earnings call. As of the usual custom on this earnings calls, I will follow my written comments in our earnings press release of yesterday, trying to put a little more meat on those bones and then we will open up the call for questions.

For the third quarter of 2011 FSP's profits as represented by FFO plus GOS totaled approximately $16.4 million or $0.20 per share, a decrease of $0.05 per share compared to the second quarter of 2011. For those of you that follow these calls you know that in my comments I usually like to talk about consecutive quarters versus year over year. Our earnings results can be quite variable because we still have a large transactional component to our business and quarter to quarter our earnings can move around, that's one of the reasons we do not give guidance. And so I would like to just go through a few things for the quarter. Why our FFO dropped $0.05 per share from $0.25 to $0.20. And all of our profit picture this quarter was FFO, as John mentioned, we didn't have any GOS again on sales this quarter.

First and foremost was our investment banking business. Our investment banking business took a hit, pretty much like most financial institutions, banking business did. For the quarter -- for the third quarter our investment banking division raised about

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$7.5 million of equity in a transaction and that is down from the second quarter's business of $42.5 million, a significant drop and certainly the biggest contributor to the drop in FFO from quarter two to quarter three.

In addition again, as John mentioned, we did some new leasing for the quarter but much of that but much of that new leasing because of build out and so on will not become effective till the fourth quarter. We actually went from about 86.9% leased to 88.1% leased. But the square footage that was FFO producing was pretty much the same between two quarters, in the 85% range. Again some of the new leasing FFO will hit in the fourth quarter.

Our third issue was our dividend income was down for the quarter. We have investments in -- preferred share investments in several single asset REITs which we receive quarterly dividends on. In addition our -- and actually, those dividends stayed fairly flat, actually rose a tiny bit. The big dividend drop occurred from our syndication called Union Center, this is the large syndication that we've been working on for a good part of the year. We as the equity owner of that investment while we are syndicating it, do get dividends on our equity investment -- on our investment in the property, our ownership position in the property and as those shares get sold and that investment starts to effectively leave our ownership and go to outside investors ownership, our dividends get reduced quarterly during that period of time.

And if we don't replace that investment from a inventory point of view then those dividends drop. We did quite a bit of business in that deal on -- in the second quarter as I mentioned $42.5 million. And dividends dropped on that syndication from about $460,000 in the second quarter of dividend income to about $175,000 in the third quarter of dividend income, that is about a $285,000 drop between the second quarter and the third quarter. And again that's -- on the one hand a good drop, because it means we are doing the banking business but on the other hand we didn't replace that inventory to replace that dividend. We actually -- in the first week of the fourth quarter have purchased a small property that we are holding for syndication, so some of that dividend income does in fact get replaced, starting in the fourth quarter.

A fourth thing that was actually fairly unique and really sort of a onetime situation, was a lease termination that occurred in our park Tn office in Houston. We actually leased three floors to a tenant there that actually needed that space to help bid on a specific project in the energy industry. And we allowed that tenant to give back one of those floors on an early term without a termination penalty and since there was free rent and so on associated with it, that tenant did not in fact get that contract, did an early term on the one floor that they had the early term right on, and not only was there no termination payment, but we had to back out almost a year's worth of straight line rent on that floor because of the free rent period. Sort of a very unique situation, it was done to attract the tenant to this space, they remain in two floors, that hit was actually over $400,000 reversal of those straight line rents. Interesting that most of these terminations cause a termination payment which actually increases FFO, in this case this termination actually decreased FFO by an excess of $400,000.

Also interesting the market -- this property is in the energy corridor in Houston on I10. That market has actually strengthened quite a bit since we signed that lease and we have prospects for that floor at higher rents than the original lease had on those floors. So we are optimistic about the re-lease there at higher rent.

Lastly, on acquisitions, we have been working on several acquisitions for the quarter but wound up just making just one, the Evanston, Illinois acquisition which John mentioned for about $35 million. However, that was made on the last day of the quarter so really didn't contribute to the quarter in terms of FFO and again will contribute next quarter.

So those are some of the factors in the variance between the FFO for the second and third quarter of 2011. Our directly owned real estate portfolio of 35 properties totaling about 6.9 million square feet was approximately 88.1% leased as of September 30th and that is up from approximately 86.9% leased as of June 30th. And I think the real good positive news that we feel really good about is that many many of our real, rental and leasing markets where our properties are located including you know, sub-markets that our properties are in not only did they remain stable during the third quarter but they actually started to show some moderate improvement in occupancy and rental rate level.

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And this is fairly broad based across many of our major markets and we believe we will reap the benefits of that as leases turn and we get the opportunity to lease vacant space that exists right now. And we do continue to make leasing progress in our portfolio. It will be choppy quarter to quarter but we continue to have as a overall objective to move our occupancy levels up into the 90 plus percent range by early 2012 and again with the better activity we're seeing in our markets and in our portfolio, we think that is very doable, we are very optimistic about that.

As I mentioned, they was one property acquisition completed in the third quarter of 2011 for a total purchase price of approximately $35.1 million. That property is located in Evanston, Illinois and total about 195,000 square feet, it's approximately 95% leased and this is our third property in the Greater Chicago Area. It joins our Northwest Point property in Elk Grove and our preferred share interest in 303 East Wacker, which is a CBD property in Chicago.

We had been working on a couple of other acquisitions for the quarter. We had a very large acquisition potential actually in the P&S and had some issues in the due diligence process and had to walk away from it during the quarter. We had hoped to do more acquisitions in the quarter and again the Evanston property we like very much, but again it was bought on the last day of the quarter.

We have -- and are working on additional real estate investments for the fourth quarter. We have several very large transactions that we are working on and we would anticipate some of these acquisitions coming to fruition this year, if not again in the fourth quarter, hopefully early next year.

There were no property dispositions in the third quarter as John mentioned but we do have several properties that we are actively looking at for potential disposition and so I think investors, shareholders should anticipate further property dispositions in the coming quarters from FSP.

During the third quarter of 2011, our investment banking group raised about $7.5 million of a $62 million private placement offering. That private placement offering began in March of this year, and as of the beginning of the fourth quarter, there remains still about $9.2 million of that offering to be yet subscribed. Our investment banking business as I mentioned, slowed significantly in the third quarter.

We continued to see our typical investor who is primarily a high net worth individual. We continue to see his or her confidence and interest in the commercial real estate market and putting again large sums of money in illiquid position to be very very dependent on their confidence in the broader capital market and particularly the confidence in the stock market. And as the stock market remains very volatile and had some problems obviously in the third quarter, the investment banking business truly slowed down. And again, I don't think we are much different than most other investment banking business in that regard, whether you are have our profile or another profile, investment banking business was just tough in the third quarter. A capital raising effort in this business over any specific period of time has always been unpredictable, but as long as volatility and uncertainty remains in a broader capital market, I think it is likely to remain even more so.

In summary, sort of a view from 10,000 feet is that we are very very positive on real estate trends that we are seeing in our sub markets and within our portfolio. Again, quarter to quarter, there can be some variability but we really believe that the trend has turned and the trend is our friend. We however do remain uncertain about investment banking and believe that will be very volatile and questionable quarter to quarter. With that, I will be happy to open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator instructions)

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Your first question comes from the line of Dave Aubuchon from Baird. Please proceed.

Dave Aubuchon - *Robert W Baird - Analyst*

Good morning guys, George mentioned that you are working on several very large transactions, can you -- I know you want to be sensitive to that obviously, but can you provide a little bit more detail on maybe what you are looking at and where pricing seems to be settling these days, including the deal you did on Evanston?

George Carter - *Franklin Street Properties Corp - President, CEO*

Hi Dave, I can't. I am very sensitive about these ones that we are working on. There's a lot of factors involved in it which will not be appropriate to talk about, will not be good for the company to talk about. The Evanston property is an interesting one. It is somewhat typical of what's going on in the market place right now and that seems like in the fourth quarter of last year and in the first quarter of this year, there was some activity, some good pricing of properties again -- particularly, some of the core properties and particularly obviously in the gateway markets and so on, which people talk so much about. It brought out a lot of properties.

A lot of brokers and sellers really really put properties on the market in anticipation of some pretty good pricing. What has been found out is really sort of a tale of two cities. If you are not core gateway, if there is any question about credit quality of tenants, lease terms, re-lease, weakness in the market that your property is in, prices just didn't pan out for a lot of properties that came on the market.

The vast majority of those properties just never sell, they are just taken off the market and the seller realizes that he can't get the value that he thought for the property. However, there are a few that get in a position where they need to sell, they made another commitment. They have something which requires them to clear at the market and these properties that we've been bidding have been those properties, they have normally been out in the market, have failed to sell at original pricing. We get calls from sellers who know we can clear at the market because of our financial capability, and those are the ones that we are working on.

We've only made one of those -- the Evanston property which was bought at better than a 9 1/2 cap at substantially below replacement cost square footage, in a real great location and a great community, served by commuter trains on both sides of it and you know, I would say that in general, the opportunities going forward are better over the next quarter or two that we are looking at, than we have seen all year. Again I am pretty optimistic about making some marginal real estate investment. Again, to talk about them would be inappropriate at this point Dave.

Dave Aubuchon - *Robert W Baird - Analyst*

Just -- well I has a question regarding that, just to be clear. Are they generally stabilized portfolios that you are looking at or are you that confident about the leasing environment where you will willing to buy some more value adds of deals.

George Carter - *Franklin Street Properties Corp - President, CEO*

I would say in general Dave they are falling a little bit more on the value add side of the equation where we think we have some very specific capability to add or very specific knowledge that would change the risk and reward equation for us versus the broader market.

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Dave Aubuchon - *Robert W Baird - Analyst*

Okay. Then on the Evanston deal -- this is a specific question. Is there a fairly big sub lease space in that building?

George Carter - *Franklin Street Properties Corp - President, CEO*

Yes. The main tenant in that property has sub leased space. The main tenant in that building is Houghton Mifflin, a private company, printer of text books and that sort of thing. And they have sub-leased part of their space in that building.

Dave Aubuchon - *Robert W Baird - Analyst*

And that lease directly runs for how long? When does it expire?

George Carter - *Franklin Street Properties Corp - President, CEO*

We have about four and a half more years.

Dave Aubuchon - *Robert W Baird - Analyst*

Four and a half more years, okay. And then the rents relative to market right now what, about?

George Carter - *Franklin Street Properties Corp - President, CEO*

They are pretty close to market right now.

Dave Aubuchon - *Robert W Baird - Analyst*

Okay, relative to your 90% -- I don't want to call it goal, but you have quoted at 90% level a couple of times in the last couple of quarters and you said you think you can get there by early 2012. What sort of cap ex assumption are you assuming to get to that number?

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

I don't really have a target in mind to get to that number.

George Carter - *Franklin Street Properties Corp - President, CEO*

It's pretty variable, depending on the property we are talking about. I mean, we have been averaging anywhere between $25 to $35 per square foot, I wouldn't think we would be too far out of that range one way or the other.

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

So we are at 88.1% now spoken for, so we are not that far away from reaching 90%. Obviously to get to 90% is not probably a whole lot of dollars.

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Dave Aubuchon - *Robert W Baird - Analyst*

Okay, and then one last question. Looks like the share count went up in the quarter. Did you issue equity during the quarter?

George Carter - *Franklin Street Properties Corp - President, CEO*

We did a small amount on our ATM.

Dave Aubuchon - *Robert W Baird - Analyst*

So the shares outstanding right now John are about 82.9 million, is that the right number to use for Q4?

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

Yes, that's right. We issued 82.937 million.

Dave Aubuchon - *Robert W Baird - Analyst*

Alright, thank you guys.

George Carter - *Franklin Street Properties Corp - President, CEO*

Thanks Dave

Operator

Your next question comes from the line of John Guinee from Stifel, please proceed.

John Guinee - *Stifel Nicolaus - Analyst*

Hi, okay. You answered the question on common equity. Any chance you would access the preferred share market?

George Carter - *Franklin Street Properties Corp - President, CEO*

Hi John, its George. Not likely anytime soon, John.

John Guinee - *Stifel Nicolaus - Analyst*

Okay, and then the second you know, if I look back and our FAD or AFFO number was $0.53 in 2010 against the $0.76 dividend. At the rate you are going this year you will be kind of $0.40 to $0.45 against the $0.76 dividend. You know, as some time I think you just have to sort of come to grips with the fact that this $0.76 dividend is artificially high and unsustainable. What do you think?

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George Carter - *Franklin Street Properties Corp - President, CEO*

We look at the dividend every quarter and try to make the right decisions about it. I think for us John, I know we've had this conversation before in meetings and so on. In the lower leverage model that we have and in the model where we have as part of our objective, real gain on sale and cyclical investing where we invest a lot of money at down part of the cycles and try to harvest those gains at the up part of the cycles. Again with low leverage and lots of flexibility, we turn to look at investing as investing whether it's existing properties or new properties.

We tend to try to balance that out through the market cycles. I mean if you took for example just this year, the sale of the two properties that we have sold and the actual gain on sale which we report as GOS, the cash gain on sale there is very close to the actual gain on sale that you report, i.e. the depreciated gain on sale is not that much different from the actual cash gain on sale we made on those properties.

Now if you take those cash gains on sale and add them into the equation from a pure cash profit point of view, we have covered the dividend. So again, it's the way of looking at it. If your point is you keep spending in a down market, more cash on an operating basis then you bring in, and you cannot see the uptrend anytime in the future and you keep rolling down and down and down, of course you have to adjust dividends and of course the board would do that. At this point, we are simply not there and just have a very different view of that with our model than you do.

John Guinee - *Stifel Nicolaus - Analyst*

All right, second question. I think you are -- sounds like you are going to be fairly aggressive on both the acquisition and disposition side of the equation. Do you have a sort of a maximum debt to total market cap number we should think about or percentage?

George Carter - *Franklin Street Properties Corp - President, CEO*

I think long term, John, you know if you keep us in that 20% to 30% level long term, I think that may be close to what we're doing. We believe that is a conservative number and if we keep our -- the vast majority of our debt unsecured, which is what we've done to date and what we plan to do, I think that makes for a very conservative flexible model, which allows us to do just what we just talked about, relative to FAD and dividends and that sort of thing.

However, I will tell you that at points in time, we could be substantially over that and substantially under that, as we make acquisitions, possibly equitize them in the future, go below those numbers and above those numbers. But if you are looking sort of a long term at a debt to total market cap level, I think that 20% to 30% is a good number.

John Guinee - *Stifel Nicolaus - Analyst*

Great, all right thank you.

Operator

Your next question comes from the line of Jeffrey Lau, from Sidoti. Please proceed.

Jeffrey Lau - *Sidoti & Co. - Analyst*

Hi, good morning.

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George Carter - *Franklin Street Properties Corp - President, CEO*

Hi Jeff

Jeffrey Lau - *Sidoti & Co. - Analyst*

I have a question in regards to I guess on an average basis I guess, on the properties on the East side or the East region. I guess it looks like you know, occupancy had a healthy increase but then the rents fell a bit. Is they are reason I guess what you are seeing from that region as opposed to other regions?

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

I can't speak specifically to regions Jeff. I don't have that data in front of me. You get that from a supplemental report?

Jeffrey Lau - *Sidoti & Co. - Analyst*

Yes, it's just like on an average basis, it seems like the rents dropped but occupancy did increase. I didn't know if it was just from like a specific property or it's just the trend you are seeing from that region.

George Carter - *Franklin Street Properties Corp - President, CEO*

I think -- this is George]. Most of those leases that are still rolling you know, were signed on average five years ago. I mean the average lease in a suburban office property is five years. And so if you think about when those leases were signed and when those leases roll, you know there are still roll downs. Our big lease roll we've gotten through and consequently our big roll down we've gotten through. And rents have stabilized now, again as I said in most of our markets that we are starting to see rents slowly moderately start trending up.

But still on leases that roll that were signed five years ago, you still have broadly speaking, roll downs from those levels so I don't think it's anything specific as it's just the timing of the market cycle when leases were signed and when they roll.

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

The most significant one Jeff, that we've had in recent memory is our property in East Baltimore, we had a law firm step out of space, that was a pretty good size drop and that might account for some of what you are seeing but I think you need to take what George said, just over a five year period as you know the way that the trends have been.

Jeffrey Lau - *Sidoti & Co. - Analyst*

Okay, this is a follow up question to that, in terms of I guess, lease renewals. I noticed that you said a majority of the leases for 2011 are month to month. Is it still that case or how is the lease renewal coming in terms of this year and next.

George Carter - *Franklin Street Properties Corp - President, CEO*

Yes, as you can see, when you look at the earnings release the supplement, our percentage roll in the portfolio is quite modest over the next couple of years and we feel pretty good about lease renewal in terms of early negotiations with tenants, possible

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renewals and/or filling that vacant space if they do not renew. We are positive about the portfolio in general and our markets in general and pretty positive about the lease renewal possibilities on all spaces coming up.

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

I think when you look at the press release Jeff, we have about 1.8% of the portfolio rolling through the rest of 2011 and 4.7% in 2012. And if I can sort of link this back to what John Guinee said earlier. You know, when it comes to cap ex we've had significantly more maturities in the portfolio that required cap ex in the last year you know, which is sort of behind us know than what is really in front of us, and what is in front of us we feel a little bit more confident that some of these tenants are more likely to renew as opposed to leave and finding new tenants to fit into that space. So I don't think there are many months to months, it's more of a few. We do have some months to months, obviously everybody does but I think it's more the level of larger tenants maturing in the next year and a half is lower than what we have seen.

Jeffrey Lau - *Sidoti & Co. - Analyst*

Okay, and in my last question. I missed a question on the -- I guess the share account. Did you say that there was a number that we should be using for the fourth quarter and where that number came from?

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

Yes, it's right on the face of the 10-Q that we filed last night but --

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Jeffrey Lau - *Sidoti & Co. - Analyst*

Okay --

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

But it is 82,937,000 and that reflects about a 1.5 million shares that we issued through the ATM in the fourth quarter. I mean I am sorry, in September.

Jeffrey Lau - *Sidoti & Co. - Analyst*

Okay, okay great. Thank you.

Operator

We have one follow up question from Dave Aubuchon from Baird. Please proceed.

Dave Aubuchon - *Robert W Baird - Analyst*

Hi guys, one more -- couple more. The portfolios that you are looking at in terms of acquiring, any significant amount debt on those assets?

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George Carter - *Franklin Street Properties Corp - President, CEO*

No

Dave Aubuchon - *Robert W Baird - Analyst*

Okay, John have you -- latest conversations, thoughts about issuing additional debt in this market from a term loan perspective? Sort of, can you walk through some of the latest -- maybe conversations that you've had with the bankers?

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

We've talked with a few different groups just to sort of see where the rates are and obviously the long term rates are very attractive right now. We'd like to match up new debt that we bring on with acquisitions, so I think it would be more likely timed when we have a significant amount of acquisitions, in mind that we think we are going to close on to think about that. So we haven't reached a conclusion yet.

However you know if you look at where we are right now, interest rates are pretty low and the Fed's fairly well committed I think through the election of next year to keep the rates low. So I think we've got some time to evaluate that before stepping into you know, some more long term debt.

Dave Aubuchon - *Robert W Baird - Analyst*

Okay, and in terms of just maturity lengths, what sort of time -- what sort of lengths are you looking at right now? Five to seven years of debt when you do make those deals?

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

Nothing really specific in mind. We've looked at five, seven and ten year from a -- just from an informational perspective but we're not really engaged in any conversations and/or started anything formal. We are just sort of trying to understand it a little bit better.

Dave Aubuchon - *Robert W Baird - Analyst*

Okay, and then just real quick. How much do you have left in the ATM?

John Demeritt - *Franklin Street Properties Corp - EVP, CFO*

About $32 million?

George Carter - *Franklin Street Properties Corp - President, CEO*

About $35 million.

Dave Aubuchon - *Robert W Baird - Analyst*

All right, thanks.

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Operator

I will now like to turn the call over to Mr. George Carter for closing remarks.

George Carter - *Franklin Street Properties Corp - President, CEO*

Hi, just thank you all for tuning in and look forward to talking to you next quarter.

Operator

Thank you for your participation in today's conference, this concludes the presentation, you may now disconnect. Good day.

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